$50.00 ANNUALLY
40 Letters Per Year

DOW THEORY LETTERS, INC.

"The Market as Interpreted under the Dow Theory"

RICHARD RUSSELL
P. O. Box 15196
San Diego 15, California

Registered with the Securities and Exchange Commission

All Rights Reserved

THE MARKET On July 22 a long "line" in the Averages was violated. The lower limits of the line were 701.35 (Industrials) and 168.97 (Rails). Penetration by both Averages through the upper or lower limits of a line generally indicates a continuation of the movement in the direction of the penetration (in the current instance, down). Added authority for the movement is provided if volume expands on the breakout.

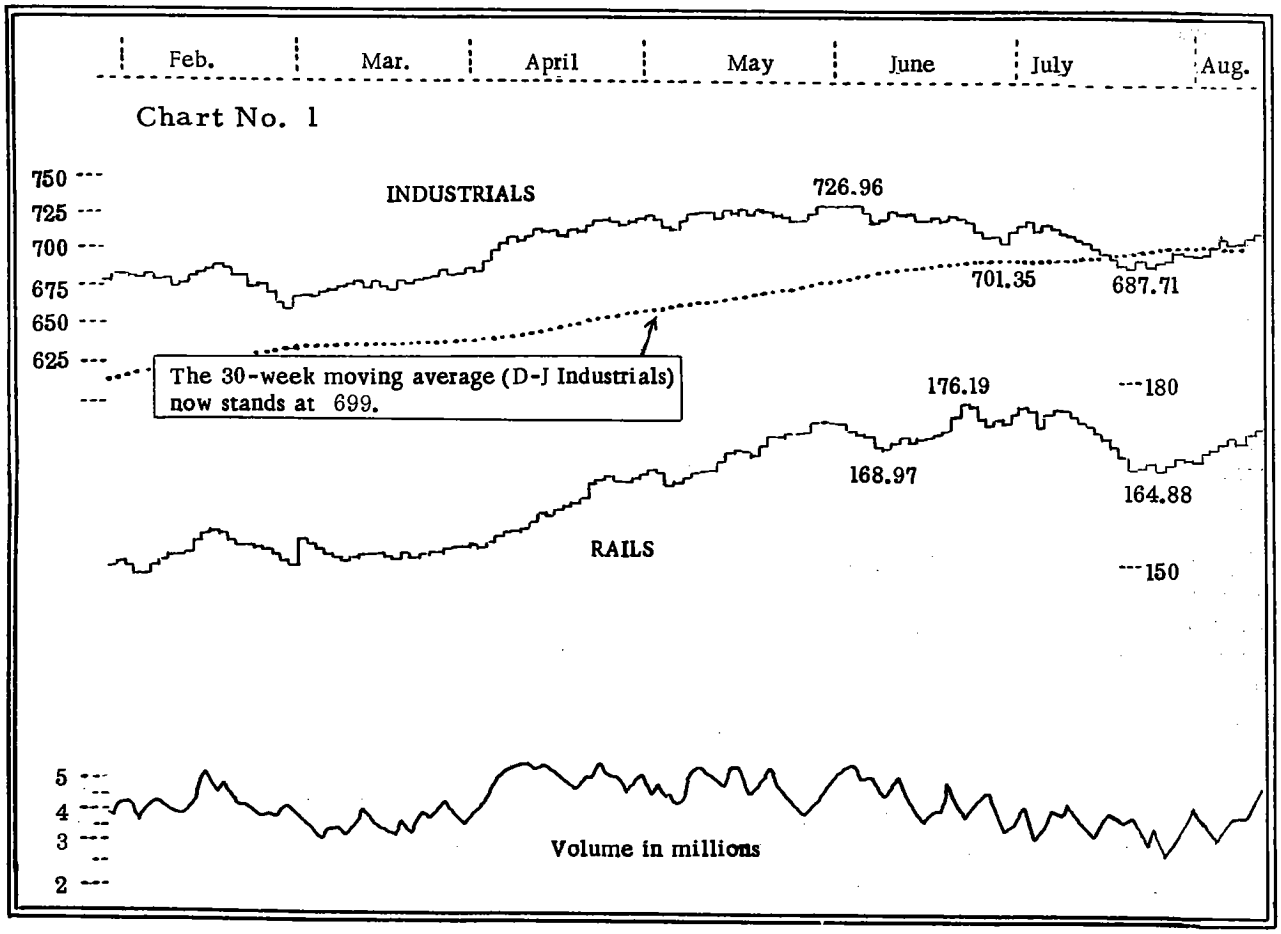
Volume following the July 22 line penetration was dull, and this lack of selling pressure was commented upon. Furthermore, the downside penetration of the line came during a string of ten declining days, a performance which left the market in a somewhat "oversold" condition (at least as far as the short-term was concerned). Following the breaking of the line, Industrials dropped to 687.71, Rails to 164.88 (see Chart #1). From these levels, a rally began.

On August 5, Industrials rallied back above their 30-week moving average, and the next day (August 6) saw Industrials again enter within the area of the line (the lower limits of which were 701.35). Rails followed "in gear", and on August 6 the carrier Average also pushed above the lower limits of its line area (above 168.97).

In the last Letter I stated that "based on diminishing volume during the decline and based on past history, the chances are fairly good that the Industrial Average (but not necessarily the majority of issues) will make some sort of attempt to enter the 720-734 area again." The odds for a recovery rally were further discussed in the section entitled "The Moving Average" (Letter 226), and I strongly suggest that subscribers read that section again.

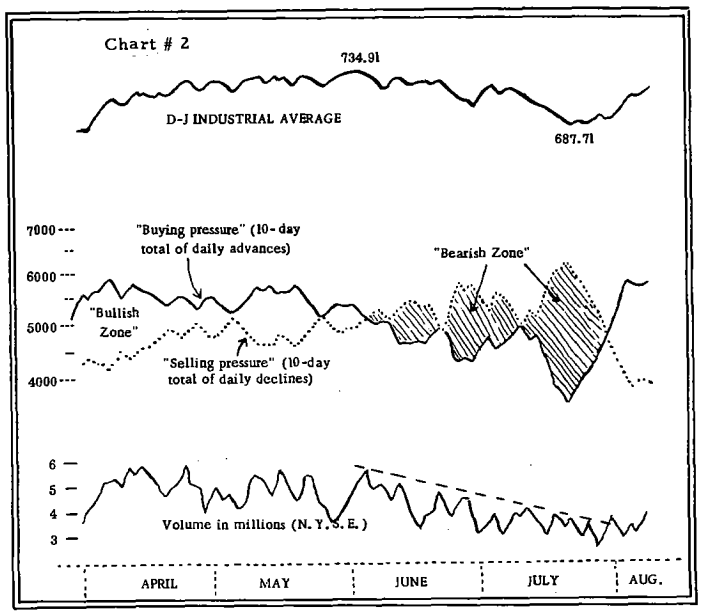
The "acid test" of market strength or weakness is now underway. As of this writing, the two Averages have rallied back into the 700-713 area (Industrials) and 168-172 area (Rails). Such action represents no more than the normal one-third to two-thirds retracement which can be expected after any decline.

If the June-July reaction lows (i.e., 687.71, 164.88) represented the worst that could be seen ahead by the combined intelligence of the market, then it will be merely a matter of time before both Averages approach, then hurdle their May 31 peaks (726.96, 176.19). Conversely, if one or both indicators fail to better their May 31 highs, and they then turn down and violate the 687.71 and 164.88 levels on increasing volume, we will



have received a signal to the effect that a primary bear trend has again gripped Wall Street.

BUYING AND SELLING PRESSURE On August 2, following a 40-day period in which selling pressure was dominant, the buying line crossed above the selling line. Volume tended to expand during the bullish position, and on August 9 and 12 (for the first time since July 11) daily volume rose above the 4 million share mark. The strength of the bullish forces will now be gauged by the ability of buying pressure to hold persistently above the selling pressure line and the ability of volume to expand as (or if) the two lines increase their bullish spread (see chart #2).



SPECULATION I have written a good deal about the lack of speculative interest in the current market. Last week (Letter 226) that market place of "speculative wares", the American Exchange, saw its advance-decline ratio drop to a new 1962-63 low. This was a low which took the American under its June, 1962 "crash" low and under its October, 1962 "Cuban scare" low. The meaning of the new low is obvious -- the speculative junior Exchange continues in a definite bear market of its own.

This trend of successive new lows on the American A-D ratio has been going on since 1961. On a relative strength basis, the American has persistently acted worse than the N.Y.S.E. One of the things I have been watching for is a hint that the A-D ratio on the American is beginning to act better than the A-D ratio on the N.Y.S.E. When this occurs (and it will some day), it will be a strong signal that speculation is reviving again. But as of now, there is no questioning the fact that the American continues to act very much worse than the N.Y.S.E. The poor breadth showing on the American is a warning that speculative accounts are not fated to do well in the current market.

Chart # 3 traces four other leading barometers of speculative interest over the past three years. Note that during the last few months three of these indicators have retreated toward their lows again. The fourth, odd-lot volume as a percentage of total N.Y.S.E. volume, has simply held at its record low of approximately 7.8% (10% may be considered "normal" for this indicator).

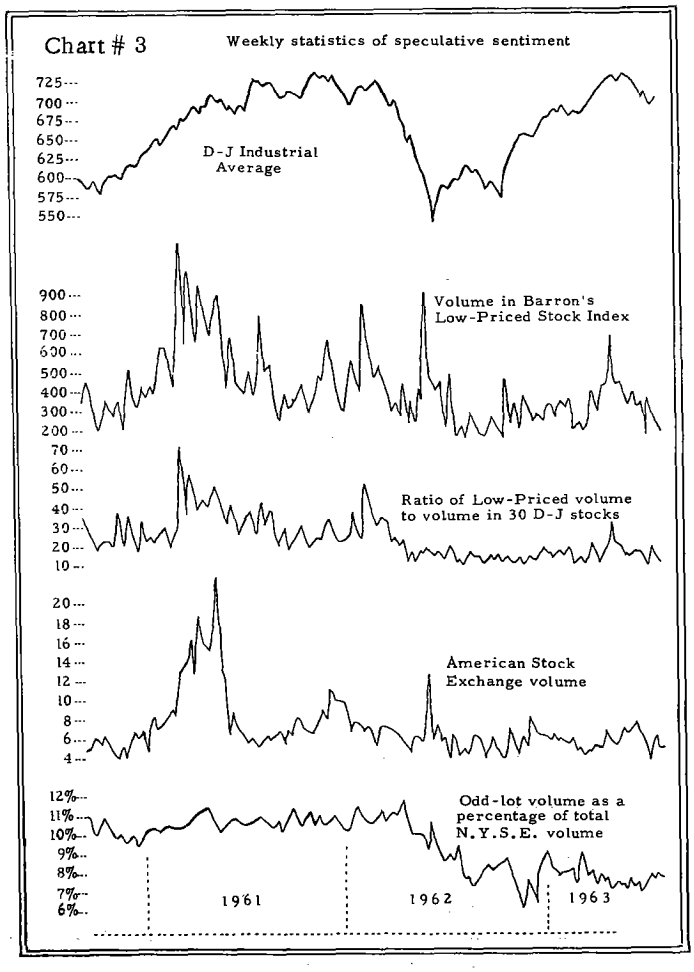


Chart # 3
Weekly statistics of speculative sentiment
D-J Industrial Average
Volume in Barron's Low-Priced Stock Index
Ratio of Low-Priced volume to volume in 30 D-J stocks
American Stock Exchange volume
Odd-lot volume as a percentage of total N.Y.S.E. volume
1961
1962
1963

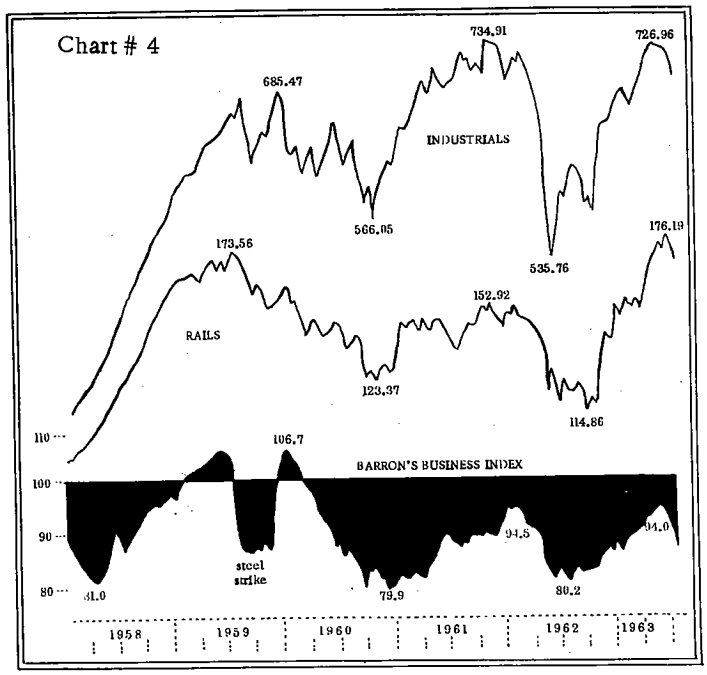
The question arises: "Can a market really 'move out' with no speculative following?" The answer is that in order for an advance to continue, sooner or later it must attract an expanding public interest. In the absence of public interest, a rise will usually "fizzle out" and retrace its gains. This is what occured in 1947 following the 1946 crash, and it happened again in 1948. During the entire period from 1946 to 1950, odd-lot volume as a percentage of total N.Y.S.E. volume was in a declining trend. In both 1947 and 1948 the Industrial Average approached the 1946 peak (212.50); then interest seemed to fade, as the market tested the 1946 bottom again.

My opinion is that unless public interest can be attracted to the current market, the Averages will not be able to extend their gains beyond recent highs. So far, there is no hint that the public is ready to come back again.

THE AVERAGES AND BUSINESS Measured from its current level, the D-J Industrial Average has gained roughly 20 points over the past four years while the Rail Average is now approximately where it was at its July, 1959 peak (see Chart #4). This sounds as if "nothing much has happened" since 1959. In terms of total net gain, this is true, but in terms of pointage traveled the Averages have been on a veritable roller coaster for four years.

These Letters are studied by many businessmen (who may or may not own stocks), and for this reason I have made it a practice periodically to compare the movements of the Averages with

Barron's famous Business Index. Over the years Barron's Index has proved to be a sensitive indicator of cyclical expansion and contraction. I stress the word "cyclical" because Barron's Index measures the components which make for important cyclical swings (i.e., steel, oil, coal and electric power production and rail carloadings). Barron's Index is also properly adjusted for seasonal and population growth trends (factors which, unfortunately, many other so-called business indices do not take into consideration).



Important turning points and subsequent movements in Barron's Index are well worth studying. The 1958-60 economic expansion took Barron's Index from a low of 81.0 to a peak of 106.7. The recession which followed took the index to a low of 79.9. The 1960-61 expansion then advanced the index to 94.5, and this was followed by the 1962 decline to 80.2 (July, 1962).

The latest rise has taken Barron's Index from its 1962 low of 80.2 to a June 10, 1963, high of 94.0. The June high came a few weeks after the May 31 peak in the Averages. From the May peaks, the Averages have retreated to secondary lows of 687.71 and 164.88. During that period Barron's Index dropped sharply from 94.0 to last week's low of 85.3. Thus the Index has recently lost more than half of its 1962-63 gains.

The question: have we seen the peak of this period of economic expansion? Based on the recent performance of the Averages, based on the damage done to the majority of stocks (this damage shows on the advance-decline ratio) and based on the pattern of Barron's Index, my guess is that the peak of strength in this business cycle has passed.

SUNDRY COMMENTS The writer corresponds or exchanges information and services with dozens of other organizations and indivuduals. When information is received which I feel is important enough to bring to the attention of subscribers, that information appears in the Letters.

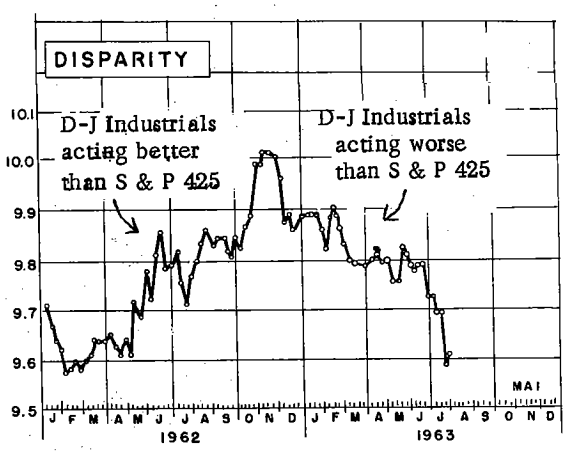
A few weeks ago I conversed by telephone with the editor of one of the best known national financial publications. The conversation went something like this: Editor -- "It would be fantastic if after all our talking, we really had a gold crisis and run on the dollar. Corporate earnings are actually better than expected, and business is holding well. Yet the market 'crashed' last year, and the recovery has not yet taken the Averages above their old highs. Something halted the recovery. We've heard 'gold and the dollar' bandied about for so long that it now sounds like the old cry of 'wolf'. But a solution to the balance of payments problem is as far away as ever, and the 'smart boys' are not even interested anymore. Nevertheless, I believe the gold and dollar situation is what is bothering the market today."

I answered: "I agree with you. Wall Street analysts have been looking at nothing but profit and loss for so long that the old timers have forgotten about money crises and the newer analysts don't know that such things exist."

* * * * * * * * *

From the latest Janeway report: "Where to Watch — the big stocks on the Big Board, where the big holdings of professional foreign money are concentrated, for symptons of a flight from dollar securities. It's understandable that foreign securities holders should fear that the 'interest equalization tax' is just a step on the road to capital control."

Mr. Janeway is an economist, not a market technician. But if one wants to watch the relative performance of the big stocks (as Janeway suggests), then one should watch the "disparity index". This index simply measures the relative disparity between the D-J Industrials (the "big stocks") and the Standard and Poor's 425 Index (a broad average encompassing a wide cross-section of all industrial issues). As seen on chart #5, the disparity index has been going steadily down since the end of 1962. This is ordinarily a hopeful indication since a persistent lag by the D-J Industrial Average behind the S & P 425 suggests that the D-J Industrials are "behind the market" and that in time they will make up the lag.



But since foreigners tend to deal in the big (i.e., Dow) stocks, one wonders whether the disparity index is saying something else -- that foreigners have been exiting from the U. S. market while leaving a tell-tale technical symptom, a steadily declining disparity index. (Disparity chart courtesy of Merrill Analysis, Box 228, Chappaqua, New York).

STOCKS Of 444 stocks tabulated here each week, 269 (61%) are now holding above their moving average (an improvement of 3% from last week). This weekly tabulation is compiled from charts published by Quote Digest, 110 North Lorraine, Wichita, Kansas.

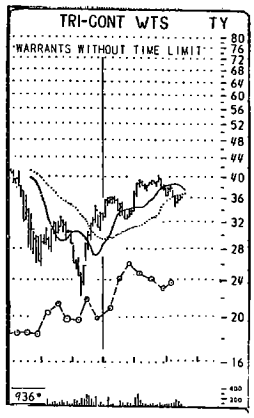
I have received an increasing number of questions regarding relative strength of stocks and groups. Ray * Signals of 141 Broadway, N.Y.C. 6 has recently been kind enough to begin trading services with me, and this organization has undoubtedly done the definitive work in the relative strength field. They have taken most of the stock groups back to the 1920's and before (in terms of relative strength), and such historical perspective can be invaluable.

It is a remarkable fact that groups can have heights and depths of popularity which may come many years (even decades) apart. For example (to start alphabetically), Airlines hit their high of relative strength (i.e., popularity) in 1945, their low in 1930; Automobiles touched their high of relative strength in 1955, their low in 1913; Chemicals hit their high in 1952, their low in 1910; N.Y. Banks hit their peak in 1929, their low in 1957.

It should be remembered that every long-term down-trend eventually strikes bottom and turns up; every rising trend touches a peak and turns down. Perhaps it is significant that the following groups touched long-term lows in relative strength in 1960-61: Sugar, Lead and Zink, Railroads, Canadian Golds.

The chart below traces four groups which are currently in long-term declines in popularity (i.e., relative strength as compared to the market). Yet each of these groups shows hints of "bottoming out" as far as the major relative strength decline is concerned. When this occurs, the groups are worth watching carefully. For instance, of the Steel group Ray * Signals comments: "The steels have lost all of their relative price gain of the 1942-1959 period and, with the exception of the early 1930's, are relatively lower than at any time since prior to the first World War. Such price actions in the past have usually accentuated the gloom but have not infrequently been the forerunner of dynamic recoveries."

At one time U.S. Steel was considered the bellwether of the stock market. This lead has now been shifted to mighty General Motors. The action of this stock (currently subject to a continual bombardment of good news) is now most important. GM touched a peak in relative strength early in May (A on chart). GM rose to an all-time high of 73 7/8 during the first week in June (B on chart). Over two months have passed, but GM has not been able either to rise above its June peak or to improve its relative strength. In fact, since May the stock has shown a slight decline in relative strength. A new high by GM above 74 could well spark a round of optimism in the market, while a breakdown in GM into the 64 or lower level would probably mean trouble for the entire list.



The small (weekly) chart shows another market bellwether, Tri-Continental warrants. I always chart this issue and have taken it back many years (showing its action as compared with the action of the Industrial Average). In the past, when the warrants have behaved poorly in the face of an Industrial advance, it has been a sign that the move lacked breadth and strength. Subscribers should watch the warrants closely; a persistent refusal by the warrants to move above 37 1/2 would suggest that the rally is a treacherous one. Conversely, if the warrants should begin to rise sharply on volume, the entire market rise would probably take on unexpected "fire".

Chart of GM courtesy of Traders Research, Inc., 1431 Pearl Avenue, Alton, Illinois 62003

Chart of Tri-Continental warrants courtesy of Quote Digest.